THE HISTORY OF CANADIAN CURRENCY, BANKING AND EXCHANGE

RE-CONSTRUCTION AND NEW SCHEMES

BY

ADAM SHORTT, M.A.
QUEENS' UNIVERSITY,
KINGSTON

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III. RE-CONSTRUCTION AND NEW SCHEMES

IN 1824 the Canadian banks were just recovering from the commercial crisis through which Canada, in common with the United States, had lately passed. So long as the bank notes had been required only as a circulating medium, the banks prospered and contributed an important service to the country, even though they were without the power to redeem in specie the greater part of their notes. This inability was simply an incident of the scarcity of specie in the country, which was itself the ground of the service which the banks rendered in supplying a medium of exchange. The bank notes had been put in circulation through the discounting of commercial paper, and the debtors of the banks expected to meet their engagements not in specie, but in these same notes. The assumption of the merchants, sound so far as it went, was that the notes with which they had parted in the course of their business would return to them in the course of their business. Under the normal conditions of sound trading this would have been the case, and there would have been no special call for specie.

But when these calculations miscarried, when, under the disorganizing influences of a crisis, the debtors of the banks could not sell their goods and meet their obligations, and when the bank notes instead of returning to the banks in payment of debts, came back for redemption in specie, the banks found themselves in a very awkward position. The strain was felt by all the banks, but not in the same degree.

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*Chief sources:
Dominion Archives; State Papers, Lower and Upper Canada.
Journals of the Assembly and of the Legislative Council, Upper Canada.
A History of Banking in the United States. By William Graham Sumner. Being Vol. I. of A History of Banking in all the Leading Nations. New York, 1896.
Kingston Chronicle, 1825-28.

The three banks of Lower Canada had been taught moderation and caution in the matter of note issue by the steady preference of the French Canadians for coin, and their custom of returning for redemption the majority of the bank notes which fell into their hands. On the other hand, the amount of coin thus kept in circulation in Lower Canada enabled the banks to replenish their vaults to the extent of the current demand. As regards the French Canadian; his prejudice insured safety but discouraged enterprise.

The business of the Quebec Bank at this time was confined to a comparatively narrow circle of merchants within the neighbourhood of that city. Having an unusually stable and compact constituency the bank was able to weather the storm without any considerable loss.

The Montreal banks had a much larger circle of note holders and customers, the latter characterized by western enterprise and its accompanying risks. The Bank of Montreal had the advantage of being able to secure the greater part of the specie and exchanges disposed of by the agents of the Imperial Treasury. Nevertheless, its losses through commercial failures were heavy; about £80,000 altogether. Its wealthier supporters were severely taxed to maintain its credit; dividends were suspended for a couple of years, and the stock fell forty to fifty per cent. Still, it managed to come through in a solvent condition, and to maintain an outward serenity which by no means reflected its inner counsels.

The other bank in Montreal, the Bank of Canada, not having the same resources, was so crippled that it was compelled to succumb, ultimately finding absorption in the Bank of Montreal.

In Upper Canada there had been an almost free field for the unchartered Bank of Upper Canada at Kingston. This institution was started by men of enterprise and character but unskilled in the mysteries of banking and without adequate capital. Yet prudence, capital, and sound knowledge of banking were more necessary in the upper than in the lower Province.

The experience of the first Bank of Upper Canada was the same as that of dozens of similar institutions in the newer regions of the United States. Untrammeled by the prejudices of the French Canadians, the bank was surrounded by settle-

ments so straitened for a medium of exchange as to be eagerly receptive of any respectable currency, and filled with amateur merchants and traders, more noted for ambition than for experience or capital. The bank had no special command of specie, and was altogether in a most unfavourable position to meet a general crisis accompanied by the usual specie famine. Its respectable paper surplus of assets over liabilities was as chaff before the wind, and when the strain came the institution went down like a house of cards.

To complete its ruin the Provincial Government undertook to direct the winding up of its affairs. In its wisdom the Government first declared the bank to have been simply a pretended and illegal affair from the beginning, and yet expected to enforce the claims held by it. For years the Government, through successive sets of commissioners, laboured at its self-imposed task with an exemplary solemnity. While creditors and debtors alike went bankrupt or prospered afresh, remained where they were or moved off to begin life anew, in this world or the next, the agents of the Government covered acres of paper with all manner of bewildering calculations, lists of names, claims and counter claims ; carefully rolling up interest against the bankrupt, the vanished and the dead ; fulminating with lawyers' letters, and otherwise living beyond their income. One set of commissioners, so completely at sea as to have lost all sense of danger, attempted to enforce by legal process a few test claims, and in the end thought themselves fortunate in escaping from court without having judgment for damages recorded against them. Their successors confined their attention mainly to book-keeping and reports to the Government, accompanied by petitions for funds, as the amounts collected did not cover their expenses. Gradually, as one follows the records from year to year, the trail of this majestic attempt at liquidation grows fainter and fainter, until, somewhere in the troubled years of the thirties, dust and oblivion have finally enshrouded the untombed remains of the first of Canada's broken banks.

The chartered Bank of Upper Canada at York had not developed its business before the crisis was well over. Having a strong political and social connection, it was ready to take fortune at the flood and ride forward on the next wave of prosperity which passed over the continent.

Though characterized in its earlier days by rather loose business methods, due to lack of experience, and distinguished more for class favoritism than for liberality and wise enterprise on the part of its directors, yet it was on the whole a well managed institution, and before the next crisis had arrived it had developed strength, acquired experience, and attached to itself many new interests.

We get an interesting view of the bank and its prospects in 1825, from one of its founders, Mr. J. H. Boulton. While in London that year Mr. Boulton, at the request of Mr. Wilmot Horton, Permanent Under Secretary of State for the Colonies, prepared a sketch of the constitution and business of the bank. In addition to particulars already given, he stated that the directors consisted of members of the Council, crown officers and other gentlemen connected with the Government of the Province, together with four official representatives of the Government, and a few men in commercial life. He thus frankly admits that the bank was in the hands of the governing body known to history as the Family Compact. This, however, he considers to be a particularly strong feature in favour of the bank. The directors, he says, of most of the other banks of Canada and the United States, are commercial men who naturally have a special eye to their own interests. But commercial men are in so complete a minority in the Bank of Upper Canada that there is no opportunity for favouritism. Apparently the members of the Government party were above suspicion in the matter of favouritism. Or more probably he believed, with his associates of the Compact, that when men are merely exercising their own peculiar privileges they cannot be regarded as acting selfishly.

Nevertheless it was quite true that the stability and strength of the Compact, with its command of the Government support, gave to the bank great credit and security in the eyes of the public. This justifies the further statement by Mr. Boulton that the confidence of the public in the bank was unbounded, and that its notes were at par, not only throughout Canada but along the American border, and only at a slight discount in New York. Almost from its beginning the bank had paid dividends of from eight to twelve per cent. on the capital paid in.

The business of the bank, according to Mr. Boulton, consisted chiefly in discounting promissory notes, generally for ninety days, at the rate of six per cent., and the buying and selling of exchanges and bullion. The notes in circulation amounted to something over £70,000, which was about double the amount of paid up capital. About £50,000 of the notes were estimated to be circulating in Upper Canada, and the remainder in the United States and Lower Canada.

These notes, he says, form the greater part of the circulating medium of Upper Canada, as the only specie which finds its way into the Province is that issued by the Commissariat to the troops.

The banks of the United States and Lower Canada, he continues, are all chartered on the same general principles as the Bank of Upper Canada, with the exception of the participation by the Government in the capital and management of the latter, which is a great advantage to the bank of Upper Canada in point of stability.

Incidentally he has the following observations to make on the general banking system of America. Though the United States are fairly overrun with small banks, extending to almost every little town, "yet, owing to their constitution, there are nothing like the number of failures there which take place in England, in proportion to the number in operation in the two countries. This, I say, arising from the differences of their constitutions, for I should be sorry to allow myself to think, as an Englishman, that it arises from the better character of the parties managing them." In fact he thinks that the system of banking as carried on in America, including Canada, could, with great public advantage, be introduced into England. The audacity of this counsel is quite charming when we consider that the English authorities at this time had adopted a policy of restriction on the note issue of the British banks with the object of forcing on the country a larger employment of metallic currency, and were seriously considering the possibility of extending similar restrictions to the North American Colonies, where, from their point of view, the evil was immeasurably greater.

With returning prosperity and the undertaking of many new colonial enterprises, both private and public, the profits to be had from the business of colonial banking and exchange began to attract attention, not only in the colonies but in Britain and the United States. This was stimulated by the effort, begun in 1825, to establish a uniform currency throughout the Empire.

Several banking and exchange projects were submitted to the Imperial Government, wherein profit and patriotism were to be combined, and the currency of the North American Colonies brought into harmony with that of the mother country. The central idea of these plans was essentially the same as that which afterwards actuated the founders of the Bank of British North America.

Though nothing came of these projects at the time, yet some of them are interesting as illustrating the ideas of the period with reference to the functions of banks in the colonies, and as exhibiting a vigorous faith in the capacity of systems of exchange to equalize international trade.

The first of these schemes was set forth by a Mr. Forbes in a formal communication to Mr. Wilmot Horton, already mentioned as the Permanent Under Secretary of State for the Colonies. It is dated London, August 24th, 1826.

Mr. Forbes puts himself into harmony with the aspirations of the Imperial Treasury at the time, by enlarging on the political and economic importance of a uniform currency as between Britain and her colonies. Trade follows the currency; a common currency is the strongest link of empire; are the new cries of the imperialist, Nevertheless, Mr. Forbes thinks there are some defects in the plans adopted by the Government. The three per cent. charge for bills of exchange on the Treasury is quite a tax upon commerce. Further, since the normal condition of Canada is one in which the imports considerably exceed the exports, there is certain to be an under supply of the usual Government and commercial bills. This forces Canadian importers to collect and export, regardless of the state of the British market, ordinary products such as grain, lumber, or potash, often to the loss of the merchants and the discouragement of British trade. As the counterpart of this,

the anxiety to obtain bills causes the British silver in the colony to be returned to the Military Chest, and the American silver to be sent to Boston and New York to compete for bills there. To the same extent it checks the American demand for British goods by raising the price of exchanges. This draining away of the circulating coin in Canada enlarges the field for the notes of the Canadian banks. The evils of such a condition are enlarged upon with all the confidence of the prevailing policy of the day, to enlarge the metal and curtail the paper in the national currency.

So far Mr. Forbes's argument, though assumed to be unquestionable, is far from sound. The difficulty of finding bills of exchange to make payment for an excess of imports is not an abnormal one to be overcome by an improved system of manipulating the exchanges. It is a very permanent and salutary difficulty; being a normal and automatic check upon overtrading. It is a check, moreover, which does not in the slightest interfere with that apparently one-sided trade, the importation and investment of foreign capital which to a very large extent comes in in the shape of goods. Though not offset by the export of ordinary wares, yet such importations are effectively balanced, as far as the exchanges are concerned, by the export of securities for the investment.

But Mr. Forbes touches upon a very real difficulty in connection with Canadian banking and exchange, when he describes how the banks are able to maintain their redeemable notes in circulation, while there is at the same time a premium demand for specie and foreign exchanges. The bank notes being redeemable in coin, why should not the importers collect bank notes, claim specie for them at the banks, and then either export it or buy Government bills from the Commissariat, or commercial bills in the American cities? A glance at the list of legal tender coins will afford the answer. For their own protection the banks tendered, in payment of their notes, worn specimens of the most over-rated coins on the legal tender list, usually French half-crowns and pistareens.

Thus, though nominally circulating freely redeemable notes, the banks were really issuing notes redeemable at a heavy discount. At the same time the banks could, and did, when it

suited their convenience, favour certain individuals with British silver or American dollars in exchange for their notes. Of course the banks could hardly be held responsible for the condition of the law of legal tender. Yet the existing condition of affairs was very unsatisfactory, and, as we shall see, was the occasion of much complaint against the banks.

To overcome these evils and to regulate the exchanges were the objects of Mr. Forbes's projected bank. He proposed to organize a company with a capital of £500,000, or more if necessary. To this company the Government was to grant permission to issue a colonial currency, to consist of re-stamped Spanish dollars, with the arms of the colony in which they are intended to circulate on the one side, and the chief features of the charter of the company on the other. These coins were to pass current at the rate of five shillings sterling and to be exchangeable at par, on demand, for bills upon the London office of the company. The re-stamped dollars would thus be simply silver bank notes redeemable in exchange on London. But, in addition to this, the company was to be permitted to circulate a certain proportion of paper notes. Apparently these notes were to be redeemable only so long as the colonies remained loyal to Great Britain, for it is held to be a special virtue of the scheme that financial ruin to the colonies would be the penalty of attempting to throw off the imperial yoke.

The company expected to undertake the whole of the home Government's colonial exchanges for America, then carried on by the Commissariat Department. It was also anxious to secure the business of the Canada Company.

As to the existing banks in the colony, it was proposed that they should simply be merged in this larger enterprise which, like the modern trust, would cover the whole field. Since the capitals of the existing banks would probably supply all the needs of the colonies, the capital subscribed in Britain would not require to leave that country.

Such was Mr. Forbes's comprehensive scheme, which was to unify the Empire, permanently maintain the exchanges at par, and enable the people of Britain to sell larger quantities of goods to the colonies, and get their returns for them in cash, without embarrassment either to themselves or the colonies.

Mr. Forbes was by no means alone in his confidence in the reality of such castles in the air. Many seemed to overlook the simple observation that if the exchanges were steadily at a premium, owing to an excess of imports of all kinds over exports of all kinds, the establishment of a free exchange at par, in return for the common currency of the colony, would simply throw the pressure back upon the currency. In other words there would soon be a currency famine, accompanied by a high premium on it owing to its accumulation in the exchange offices of the company.

The currency could be returned to circulation only by means of loans to the people. The question would next arise, to what extent would the company be prepared to grant loans? Assuming it to be proceeding upon sound business principles, it could not go very far, and when it withheld, the premium on currency must once more appear. Some check upon the tendency to over-importation was absolutely necessary, and that check was afforded by the premium on exchanges in favour of Canada. The same premium acted as a bonus in favour of exports, or investment in the country, both of which furnished exchanges in favour of Canada.

The Imperial Government, being still engaged on its own currency schemes, gave Mr. Forbes no encouragement and his plans were not brought to the test of experience.

Among others who were attracted by the Government exchanges with the North American colonies, was the famous Nicholas Biddle, president of the Bank of the United States, and for years the most prominent financial figure in America. In the important field of Anglo-American exchange, the Bank of the United States was associated during Mr. Biddle's career, with the great English house of Baring Brothers.

As already pointed out, there had always been a close dependence of the Canadian money market upon that of New York. On several occasions Mr. Biddle had found the influence of the Canadian demand for specie on Government account to be unexpectedly embarrassing. On enquiring into the exchange relations with Canada, he found that bills on the British Treasury came to New York, partly through the medium of the banks or their agents, partly through the hands of merchants and their

correspondents, and partly by direct messenger from the Commissariat. A considerable portion of the exchange was disposed of for specie which was transferred to Canada, whence it oozed back to the United States through a thousand pores of trade, requiring a transfer in mass once more. It was this irregular withdrawal of specie in large quantities to Canada which disturbed the New York money market.

It occurred to Mr. Biddle that the methods then in operation were both clumsy and wasteful, as well as liable to produce financial tension. He therefore approached the British Government in July, 1827, through his London correspondents the Baring Brothers, urging the mutual advantages to the Government and the bank of dispensing with all intermediate agencies and commissions. His proposal was that the agents of the British Treasury in Canada should dispose of their exchanges directly to the Bank of the United States in New York, the bank undertaking to supply the Government with specie as it might need it. This would insure the Government a better price for its bills and enable the bank to supply its needs without any shock to the money market.

Such an arrangement would no doubt have resulted in considerable economy to the British Government. But the mere proposal to adopt it would have caused a storm of protest in Canada. It was a strong popular belief, and a standing grievance against the banks, that the scarcity of money and the high price of exchanges were due to the unpatriotic custom of selling Canadian bills on Britain to the Americans. However, the currency plans of the Government prevented this project also from receiving serious consideration.

The following year another scheme, having as its central feature the management of the exchanges, was presented by Mr. John Galt, the well-known author and the first manager of the Canada Company.

Writing to Mr. Huskisson, in February, 1828, he laid before him his plan for assimilating the colonial currency to that of Britain, and requested that in case it were adopted he should be appointed superintendent for Canada.

He refers to the deplorable condition of uncertainty and fluctuation in the colonial exchanges with the mother country.

Under the influence of the same idea as that of Mr. Forbes, and altogether over-rating the influence of the Bank of England in adjusting commercial balances between different parts of Britain, he assumes that such an institution, by a simple mechanism of exchange, will be able to equalize the fluctuating and unbalanced trade between Britain and the colonies, and, if necessary, with the United States as well.

He points out that the attempt to introduce the British metallic currency into Canada has failed. The circulating medium of both provinces, outside of the French rural sections of Lower Canada, consists almost entirely of bank notes. British coins and even silver dollars are rarely seen. Since Canada is influenced by the example of the neighbouring States, he regards it as impossible to replace the paper by a metallic currency. His object, therefore, is to provide a paper money of undoubted security as the basis of the Canadian currency, including the bank notes.

The stability and credit of the Bank of England prove that institution to be capable of accomplishing the object in view. Let the Bank of England, through a general superintendent in Canada, furnish to agents in the leading centres, notes of various denominations from one pound upwards, payable in London. Let these notes be issued by the agents for the following purposes :—First, to the various Commissariats and Provincial Governments to meet the needs of the imperial and colonial departments. Second, for the purchase of commercial bills of exchange on Britain. Third, in exchange for notes of Canadian, and to a certain extent of American banks. Ordinary bank discounting might afterwards be added, but is not to be undertaken immediately.

After dealing with some details of organization the following results are predicted from the operation of the scheme. Bank of England notes would rank above all local bank notes, both in Canada and the neighbouring States. They would afford an immediate and uniform means of making payments in Britain. On both these grounds the notes of other banks would be readily exchanged for them, thus giving the agents of the Bank of England command over the bullion or specie in the coffers of the other banks.

The British Treasury, in making its payments in Canada, would simply put at the disposal of the bank in London the specie voted for the public service in Canada, and the payments in Canada would be made by the bank notes there. The commercial bills on London purchased in Canada would furnish additional specie, and any further demands could be met by drawing specie from the banks in America whose notes were held.

Such, in essence, is Mr. Galt's plan for putting the Canadian currency and exchange on a stable footing. The first suspicious feature in it is the ominous facility with which it accomplishes the most difficult things, regardless of circumstances. Were it capable of achieving what Mr. Galt predicts, one could not but agree with him that it might be extended over the whole world. However, the scheme is evidently weak in its foundations. No explanation is given as to whence the profits are to be derived for the support of such an extensive machinery of exchange. We are simply left to infer that in some way the bank would derive a large revenue from having its paper in circulation. But, in the first place, under the acknowledged conditions of the time the notes could not remain in circulation. The combined Government and commercial bills on Britain, whose place in exchange the notes are to take, were not sufficient to meet the demand for means of remittance to Britain. Every Bank of England note, therefore, would be immediately secured and sent off as soon as issued under the stimulus of as high a premium as the Government bills had borne. The premium, however, would not go to the bank, which must issue its notes at par, but to the receivers of the notes on Government or other account.

Again, under the plan laid down, the bank would have no profit from discounting. Neither could it gain anything from the purchase and sale of exchanges, its own purpose being to maintain a par of exchange between Britain and America. In the case of commercial bills on Britain, purchased to provide specie in London, the notes issued for them in Canada would in most cases be presented for redemption in London before the bank had received payment for the bills.

The exchange of Bank of England notes for those of other banks, with a view to obtaining the specie in their vaults, could afford no profit, but would certainly entail considerable expense

with risk of loss, unless the banks whose notes were to be taken were carefully selected. But specie would require to be collected and sent over from the Canadian and American banks chiefly when its own notes, given in exchange for these, began to reach the London office for redemption.

Even supposing that the various Canadian and American banks should promptly meet the demands for specie, and in such form as would be of sterling value in London, the bank would very soon enjoy a monopoly of the risk and expense of sending bullion across the Atlantic to balance the whole of the American exchanges, and this without the slightest compensation other than the proud consciousness of being able to accomplish the self-imposed task.

The only possible source of profit to the bank would be the interest on such advances as might be made to the Provincial Governments in Canada, and, owing to the nature of the exchanges, these advances, though issued in notes, would be speedily converted into loans of specie.

The radical weakness of Galt's scheme, which was much the same as that of Forbes, would have been sufficient to prevent its practical adoption, even had the Government been quite through with its own plans.

Shortly after his arrival in Canada Mr. Galt was so unfortunate as to outrage the feelings of the Family Compact and ruin his prospects in Canadian official life by showing some civility to Mackenzie and the radicals. Whether the radicals borrowed from Galt the idea of enlisting the Bank of England in the work of Canadian banking and exchange, or whether they developed the idea for themselves, yet, as a matter of fact, at this time and for some years afterwards, they indulged the conviction that the Bank of England could be induced to establish one or more branches in Canada.

In January 1829, Mr. Dalton, the radical, in the House of Assembly of Upper Canada, moved a series of resolutions on commerce and agriculture, the objects of which were to free the country from the monopoly of the China trade, then held by the East India Company, and to increase the capital of the country by petitioning the home Government to induce the Bank of England to establish a branch in Montreal.

In a somewhat grandiloquent speech in support of his resolutions, Dalton gave expression to a growing idea in Canada. Since the undeveloped natural resources of the country, of which men spoke as eloquently and vaguely then as now, constituted the great capital of the people of this country, that capital ought to be employed as the basis of credit. Upon the credit of these undoubted resources, it was believed that paper money might be issued to furnish the means for their development. This day-dream of economic perpetual motion, or automatic prosperity, is one in which many in America have indulged in the past, nor is it to-day altogether without its votaries among those who deal in visions.

Though it was admitted that the local banks were not strong enough to enable the country to thus lift itself by its own boot-tops, yet it was thought that the Bank of England had sufficient strength. This just meant that the new paper capital was to rest, not upon the resources of the country, but upon the capital of the Bank of England.

The officials of the British Treasury were quite sound on the subject of land as a security for bank loans, or the issue of bank notes. In denying to the Canada Company the privilege of paying a portion of its obligations to the Government in Bank of Montreal notes, the Treasury pointed out that if the company had the money on hand it could pay it over directly. If it were with the Bank of Montreal, it could demand its deposits in specie and pay that over. But if, as would appear from its application, the company were seeking assistance from the bank to enable it to make its payments, then it was specially objectionable, because the bank would have to take the company's lands as security. But land is declared to be the worst possible form of security for a bank to hold, inasmuch as it cannot be converted into specie in times of distress, just when a bank should have the most perfect command over its securities.

As the banks continued to prosper and expand during the twenties, they excited a more general public interest. Accusations of favouritism, both well and ill founded, and various real defects in the system, afforded a basis for a rising discontent and a vigorous criticism. In Lower Canada this ultimately found

vent in the House of Assembly, and would doubtless have found a like expression in the upper Province but for the power of the Compact.

Moreover, in their mutual expansion the banks came into conflict with each other, and the foundation for a vigorous bank war was laid.

An increased demand for capital and local bank accommodation, together with the desire to share in the high profits of the banks, led to attempts to establish new banks, several of which were successful. Thus we are brought to the threshold of a new set of experiences in Canadian banking with which the next paper must attempt to deal.

Adam Shortt

Queen's University, Kingston